

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Koretz Analyst: Roger Lackey Bill Number: AB 29XX
Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: 05-17-2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Power Generation System Credit Or Depreciation Deduction/Sales Tax Credit for Excess Credit

SUMMARY

This bill would:

- Allow a credit for a percentage of the cost to purchase or lease and to install a power generation system.
- Allow a taxpayer to depreciate a power generation system over five years.
- Exempt the purchase of a power generation system from the sales or use tax.
- Allow a retailer to claim a sales or use tax credit equal to the income tax credit described above.

This analysis will address the sales or use tax exemption and the sales or use tax credit for retailers only as they impact the department. This analysis will not address the bill's provisions in the Public Utilities Code or Water Code as they do not impact the department or state income tax revenues.

PURPOSE OF THE BILL

According to the author's staff the purpose of this bill is to reduce the demand on the state's power grid during peak hours.

EFFECTIVE/OPERATIVE DATE

This bill specifies the credits and special depreciation sections would be operative for taxable years beginning on or after January 1, 2001, and before January 1, 2006.

POSITION

Pending.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Brian Putler

06/11/01

ANALYSIS

FEDERAL/STATE LAW

Credit Discussion

Federal law currently provides two energy-related credits: an energy investment credit, which is a portion of the investment credit, and a business credit for the production of electricity from certain renewable resources.

The energy investment credit is equal to 10% of the basis of energy property placed in service during the taxable year. Energy property includes equipment that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat. It also includes equipment that produces, distributes, or uses energy derived from geothermal deposits. The equipment also must meet performance and quality standards prescribed by federal regulations.

The business credit provides a tax benefit for the production of electricity from certain renewable resources. It is equal to 1.5 cents multiplied by the kilowatt-hours produced by the taxpayer's qualified energy resource facility. To qualify for the credit, energy is required to be sold by the taxpayer to an unrelated person during the taxable year. Qualified energy resources include wind, closed-loop biomass, and poultry waste.

Former state law provided a credit under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL) equal to 10% of the cost of a solar energy system installed on premises located in California and used for commercial purposes. The credit was available for years beginning on or after January 1, 1990, and before January 1, 1994.

The credit provisions defined "solar energy system" as solar thermal electric and photovoltaic systems, but did not include devices that produced electricity through wind energy or energy conservation measures.

The former solar energy credit is further discussed in "Program Background" below.

Current state law does not provide any type of energy credit.

Depreciation Discussion

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. However, expenses for purchasing property with a useful life in excess of a year must be capitalized and depreciated over the recovery period of the property rather than deducted in the year purchased.

THIS BILL

Tax Allocation Committee

This bill would establish the Tax Allocation Committee (Committee) within the Treasurer's office, consisting of the Director of Finance, the Treasurer, and the Controller. The committee would allocate the respective tax credit or incentive to each qualified taxpayer, in accordance with an unspecified allocation plan.

The aggregate amount of exemptions and credits allowed by this bill could not exceed \$50 million each calendar year.

This bill would give the Committee the authority to promulgate rules, regulations, and procedures to carry out the allocation of the tax credits and incentives added by this bill.

Also, the Committee would report annually to the Legislature regarding the utilization of the tax credits and exemptions allowed by this bill and the activities of the Committee in relation to those incentives.

Power Generation Systems Purchase or Lease Credit

This bill would allow a taxpayer to make an irrevocable election to claim a credit for the costs paid or incurred to purchase or lease a power generation system installed and placed in service on property located in California for the production of electricity used onsite.

The power generation system credit would be in lieu of any other credit, exemption, or deduction allowed by this bill, and no deduction would be allowed for any costs for which this credit is claimed.

The applicable percentage of the costs subject to the credit would be:

- 30% for any solar energy, wind-driven, or photovoltaic power generation system,
- 25% for any power generation system placed in service on or after January 1, 2001, and on or before September 1, 2001, and
- 20% for any other power generation system.

“Qualified taxpayer” would mean any taxpayer that purchases or leases a qualified power generation system as an alternative means of supplying its power needs in this state.

“Qualified cost” would mean any cost paid or incurred on or after January 1, 2001, and before January 1, 2006, that satisfies each of the following requirements:

- Is for the purchase or lease of a qualified power generation system that is certified by the Energy Resources Conservation and Development Commission and placed in service in this state,
- Is an amount properly chargeable to the capital account of the taxpayer, and
- Is an amount for which the qualified taxpayer has not elected to claim the enhanced cost recovery deduction or the BOE claim for refund provided by this bill.

“Qualified power generation system” means devices either newly installed or converted from a preexisting power generation system. The system must be used for the individual function of producing electricity at the rate of 50 megawatts or less per day. A “power generation system” includes any solar energy, wind-driven, fuel cell, microturbine, photovoltaic, and natural gas generation system. “Power generation system” does not include any diesel, oil, gasoline, or steam generation system.

This bill also would define “solar energy system,” “wind-driven system,” “fuel cell system,” “microturbine system,” “photovoltaic system,” “natural gas generation system,” “steam generation system,” “compliance period,” “peak load hours,” and “placed in service.”

This bill would provide special rules in the case of a true or operating lease of a power generation system. For these leases, only the taxpayer-lessee that uses the qualified power generation system would be allowed to claim the credit. The inception date of the lease would be considered the “placed in service” date and any non-capital costs (interest factor, maintenance, etc.) would be excluded from the qualified costs used to determine the credit.

This bill would require that 80% of the electricity used by the taxpayer during the taxable year be generated by the power generation system. The bill contains a special rule for calculating the 80% requirement in taxable years that are less than 12 months and for any period during which the qualified power generation system suffers significant operational problems that limit its ability to generate electricity during a taxable year.

If the taxpayer fails to meet the 80% requirement, the taxpayer would be required to recapture a calculated portion of the credit. The recapture would be calculated based on the number of months remaining in the 60-month compliance period.

This bill would require the taxpayer to obtain and retain written certification from the state Energy Resources Conservation and Development Commission that the system is a qualified power generation system.

This bill would allow any excess credit to be carried over and used in the following six taxable years.

Power Generation System Depreciation Election

This bill would allow the taxpayer to make an irrevocable election to depreciate the power generation system over five years using the straight-line method of depreciation. This special depreciation deduction would be in lieu of the qualified power generation system credit, or the sales or use tax credit for retailers that file with BOE. The qualified taxpayer would still be required to meet the same requirements of the qualified power generation system credit. If the qualified taxpayer failed to meet those requirements, the qualified taxpayer would be required to recapture the difference between the accelerated special depreciation method and the normal depreciation deduction allowed for a power generation system.

The special depreciation deduction would be in lieu of any other credit or exemption allowed by this bill, or any other deduction allowed for those costs.

Sales or Use Tax Credit for Retailers

This bill would allow a taxpayer to make an irrevocable election to claim a sales or use tax credit for retailers required to file a return with the BOE. The credit would be equal to the power generation system credit. The credit would only be allowed if the retailer paid sales tax reimbursement or use tax for the purchase or lease of the power generation system.

The sales or use tax credit would be in lieu of any other credit, exemption, or deduction allowed by this bill.

This bill would require the taxpayer to retain substantiating eligibility for the credit.

The BOE would be required to provide an annual listing to Franchise Tax Board of retailers that claimed the credit.

IMPLEMENTATION CONCERNS

For the power generation system purchase or lease credit it is not clear how it would be determined if a power generation system generates at least 80% of the electricity used by the taxpayer if the power is generated only for onsite usage of the taxpayer and if that electricity is being used during peak load hours.

The credit is limited to power generation systems used for producing electricity at the rate of 50 megawatts or less per day. It is unclear whether the credit would extend to power generation systems with generating capacity in excess of 50 megawatts per day that actually used for no more than 50 megawatts per day.

TECHNICAL CONSIDERATIONS

Since the bill was amended to no longer allow a claim for refund, Amendments 1 would eliminate this reference in another provision of the bill.

LEGISLATIVE HISTORY

ABX 27 and AB 1124 (Koretz, 2001/2002) are identical versions of this bill. ABX 27 died when the first special session ended while AB 1124 is at the Assembly Desk.

SB 17X Brulte and Peace (2001/2002 first special session) is the identical first special session bill.

ABX 79 and AB 872(Nakano, 2001/2002) would allow a solar energy credit. Both bills are at the Assembly Desk.

ABX 15 (Rod Pacheco, 2001/2002) would allow a 100% credit for the purchase of energy conservation measures that reduce a taxpayer's electricity and natural gas use by 5% from the previous taxable year and is in Assembly Revenue and Taxation Committee.

ABX 86 and AB 1264 (Campbell, 2001/2002) would allow a 75% credit for the purchase and installation of a solar energy system for residential purposes. Both of these bills are at the Assembly Desk.

AB 873 (Takasugi, 1997/1998) would have allowed a credit equal to 40% of the cost of energy conservation measures. The bill also would have allowed a second credit equal to 10% of the cost of a solar energy system installed on premises located in California and used for commercial purposes, subject to certain requirements. The bill failed to pass the Assembly Revenue and Taxation Committee.

PROGRAM BACKGROUND

For taxable years 1990 through 1993, state law allowed a tax credit of 10% of the cost of a solar energy system installed on premises used for commercial purposes that were located in California and owned or leased by the taxpayer. The credit could not be claimed for any solar energy system with a generating capacity in excess of 30 megawatts for any taxable year unless the federal government provided at least a 10% federal credit for that solar energy system.

For 1987-1988 state law allowed a credit of 12% of the cost of commercial solar energy systems installed on commercial premises, cooperatives, apartment buildings, or other similar multiple dwellings, including buildings and any other common areas of a condominium maintained by a homeowners' association.

From 1976-1988 state law allowed the solar energy tax credit for personal and commercial premises. The credit was refundable until 1981 and was significantly modified several times. The credit was allowed as a percentage of the purchase and installation costs of solar energy systems on premises owned by the taxpayer. For 1981 and later years, any unused credit could be carried over to succeeding years.

In 1987, the percentages allowed for the solar energy tax credit were 10% of the eligible costs for single-family dwellings, not to exceed a credit of \$1,000. For commercial property the percentage was 25% of the eligible costs. However, only 15% of the eligible costs were allowed in that year for wind energy systems installed on or after January 1, 1986, and on or before June 30, 1987.

OTHER STATES' INFORMATION

Massachusetts: Currently has an energy credit that is equal to 15% of the net expenditures or \$1,000, whichever is less.

New York: For personal income tax (PIT) only, New York allows a credit for solar generating equipment equal to 25% of certain solar generating expenditures. The credit is capped at \$3,700 per system.

Michigan: Does not allow a credit, but exempts the value of energy conservation devices from the local property tax.

Oregon: Currently has two energy credits: a PIT consumer energy purchases credit, and a corporate tax credit for the costs of energy projects. The consumer energy purchases credit allows various credits ranging from \$50 to \$1,500 for consumer purchases of certain items. The corporate credit for the costs of energy projects is a credit equal to 35% of the incremental costs of the project involving energy conservation and other related projects.

FISCAL IMPACT

This bill would not significantly impact the department's programs and operations.

ECONOMIC IMPACT

Tax Revenue Estimate

Based on the discussion below, it is projected that all of the annual dollar amount (\$50 million) would be allocated each year.

Tax Revenue Discussion

The impact of this bill would depend upon the number of taxpayers and businesses incurring qualifying electric power generation expenses and the average credit applied against tax liabilities.

This bill is expected to have a significant incentive effect, despite the low levels of solar and other alternative type power generators used by taxpayers and businesses in this state. Qualifying electric power generation systems generating capabilities and resulting costs can range significantly. For this analysis the following data and assumptions were used:

- An average cost of approximately \$13,200 for 2001 was used (net of special rebate programs) for a solar energy system installed on single-family homes.
- 1% of all homes will install a solar energy system by 2006.
- An average cost of approximately \$143,000 for 2001 was used (net of special rebate programs) for mid-size systems between 10 kilowatts and 200 kilowatts.
- Average costs were not reduced by allowable federal credits.
- Projected volumes for mid-size systems were based on the California Energy Commission's projected rebate program.
- Assumed in aggregate that 100 megawatts for large systems would be achieved annually after the first full year of implementation.
- Assumed that all other systems would represent approximately 10% of solar systems.
- Assumed in aggregate recapture of credits would not exceed 10% of original claims.
- Adjustments were made to account for offsetting tax effects of deductions for depreciation that would be otherwise allowed under current law.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 29XX
As Introduced May 17, 2001

AMENDMENT 1

On page 22, strikeout lines 8 and 9, and insert:

Section 23684 or Section 6902.3, any exemption allowed under Section 6367.5, or any deduction otherwise allowed by this part for any